

Decision **DRAFT DECISION OF ALJ WONG** (Mailed 5/22/2002)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Southern California Edison Company (E 338-E) for Order Approving Proposed Settlement Agreement Regarding QFID 2180 and Authorizing Edison's Recovery of Payments Made Under the Proposed Settlement Agreement Between Edison and the County of Los Angeles.

Application 01-09-027
(Filed September 19, 2001)

OPINION REGARDING THE SETTLEMENT AGREEMENT**Summary**

Southern California Edison Company (SCE) requests that that we approve the settlement agreement between SCE and the County of Los Angeles (County) regarding the County's cogeneration facility at the Pitchess Honor Rancho correctional facility located in Saugus, California. The settlement agreement would resolve certain disputes about the firm capacity performance requirements contained in the qualifying facility (QF) contract that SCE and the County entered into.

Today's decision approves the settlement agreement between SCE and the County resolving these disputes. The decision also authorizes SCE to recover all payments made or to be made by SCE to the County pursuant to the settlement agreement approved herein.

Background

SCE and the County entered into a power purchase contract on November 5, 1985, using a Commission-approved standard form QF contract, commonly referred to as a Standard Offer No. 2. The contract provides that SCE will purchase energy from the County's cogeneration facility. The length of this contract is for 30 years. The County's cogeneration facility became operational in July 1988, and was declared to be in "firm operation" under the terms of the contract in November 1988.¹

Under the contract, the County elected to provide SCE with 22.204 megawatts (MW) of firm capacity (contract capacity) in exchange for a capacity price of \$165 per kilowatt per year. Section 6.1 of Appendix B.2 of the contract provides that the County will receive full capacity payments only if it delivers the contract capacity during the on-peak hours in each peak month, subject to a 20% monthly allowance for forced outages. Under Section 8 of Appendix B.2 of the contract, if the County does not meet the minimum

¹ The contract was first amended on July 31, 1987. The contract was amended for a second time shortly after the Commission approved some QF amendments in Decision (D.) 01-07-031, including the approval of Amendment No. 2 to the QF contract between SCE and the County. A draft of Amendment No. 2 was attached to Tab 1 of SCE's June 13, 2001 motion that was filed in R.99-11-022, and which was approved in D.01-07-031. According to Section 3.2.4 of that draft Amendment No. 2, "all issues between Edison and Seller [County] arising from (a) Edison's non-payment for electricity delivered by Seller from November 1, 2000 through and including March 26, 2001, (b) Seller's performance or non-performance under the Contract from January 1, 2001 through and including the Effective Date, to the extent such performance or non-performance was caused by the factors identified in Seller's declaration under penalty of perjury as provided for in Section 3.2.5 below, and (c) Seller's payment or non-payment of amounts owing to Edison under the Contract or otherwise shall be resolved."

performance requirement in Section 6.1, and its performance is not excused by an uncontrollable force as defined in Section 4.33 of the contract, the County may be placed on probation for a period not to exceed 15 months. If the County fails to demonstrate that it can deliver contract capacity during this probationary period, Section 8.1.3 of Appendix B.2 provides that the contract capacity may be derated to the greater of the level of capacity actually delivered during the probationary period or the capacity level that the County is reasonably likely to meet. In the event of a derating of contract capacity, Section 8.1.3 of Appendix B.2 and Section 5.5 provide that the County would owe SCE a capacity overpayment refund. If the failure to perform is excused by an uncontrollable force, then SCE is obligated to continue the County's capacity payments for up to 90 days and the County would not be subject to probation and derating.

The disputes that are the subject of the settlement agreement focus on whether the County should be excused from meeting the contract's firm capacity performance requirements in July and August 1999 because of certain alleged uncontrollable force events.² These events include the failure of a steam turbine at the facility and subsequent delays by a third-party contractor in making the required repairs to the turbine. SCE contends that the County had failed to carry its burden of establishing the existence of uncontrollable forces and reduced the County's capacity payments for the two months in question. The County argues that SCE had improperly rejected the County's claims of uncontrollable forces, and that SCE had underpaid the County \$788,501.31 for capacity delivered in

² The various disputes and the negotiations leading up to the settlement are described in more detail in the "Prepared Testimony and Qualifications of Lars E. Bergmann and Cathy L. Mendoza" (prepared testimony).

July and August 1999, and for winter bonus payments during the period from October 1999 through May 2000.

SCE and the County also dispute whether SCE had properly instituted a probationary period when the County did not meet its performance requirements in July 1999. They dispute whether SCE had properly derated the project from 22.204 MW to 10.325 MW³ when the County failed to demonstrate its ability to deliver the contract capacity during the first month of the probationary period in August 1999. SCE began offsetting against the payments for deliveries from October 2000 through part of January 2001. The offset was to collect the capacity overpayment refund obligation that SCE calculated as being equal to \$7,150,579.95 as of October 1, 2000.

SCE and the County initially began negotiations to settle the disputes in September 2000. However, these negotiations were unsuccessful and no agreement was reached.

During the time of the ongoing dispute between SCE and the County, wholesale electric rates in California began to rise dramatically. According to SCE, it continued to meet customer demand by procuring power at exorbitant rates. However, SCE was unable to pass these costs through to customers because SCE's authorized rates were lower than the prevailing wholesale rates. This resulted in a severe cash flow problem for SCE, and impaired its ability to borrow funds.

SCE filed a petition and two motions before the Commission in which it asserted that a number of factors were causing short-run avoided cost (SRAC)

³ The derating became effective on October 1, 2000.

energy prices, including those provided for in the contract with the County, to exceed the avoided cost limits imposed by federal law. As a result of a combination of these factors, SCE suspended payments to QF generators and other creditors beginning in late December 2000. Consequently, SCE did not make payments to QFs for energy deliveries in November through March 26, 2001.

In D.01-03-067, we agreed that the formula for calculating SRAC prices was flawed, and modified the formula as of April 1, 2001. SCE was also ordered in that decision to resume payments to the QFs for deliveries on and after March 27, 2001. SCE continued to contest the lawfulness of the SRAC prices for the period from November 2000 through March 26, 2001.⁴

The suspension of the payments to the QF generators and the issuance of D.01-03-067 resulted in about 30 lawsuits being filed against SCE by the QFs. Starting in June 2001, SCE began to enter into a series of agreements and contract amendments with the QFs. According to SCE, these agreements and contract amendments generally provided for the following: “(i) payment for past power deliveries upon the satisfaction of certain conditions; (ii) a five-year alternative energy price; (iii) stays of or forbearance from litigation to permit Edison time to address its liquidity concerns; and (iv) full releases and dismissal of litigation upon payment by Edison.” (Prepared Testimony, p. 8.)

During this time of turmoil in the energy markets, SCE and the County held further settlement discussions. A settlement agreement was subsequently reached, which became effective on July 5, 2001.

⁴ See footnote 1.

The terms of the settlement agreement are contained in the “Settlement Agreement Between County of Los Angeles (Pitchess Honor Rancho, QFID 2180) and Southern California Edison Company.” The settlement agreement, as well as an unredacted copy of the application and an unredacted copy of the prepared testimony were filed under seal. Redacted copies of the application and the prepared testimony, and the full version of the contract and amendment between SCE and the County, were filed with the Commission. When SCE filed these public and non-public pleadings, SCE also filed a motion for a protective order to keep the settlement agreement and the confidential and sensitive information in the application and the prepared testimony sealed. In a ruling dated October 17, 2001, the assigned ALJ granted SCE’s motion to keep those materials under seal, and to limit access to the non-public version of those documents.

SCE seeks Commission approval of the terms of the proposed settlement as reasonable, and that it be authorized to recover all payments made or to be made by SCE to the County pursuant to the settlement agreement, subject only to SCE’s prudent administration of the settlement agreement and the QF contract between SCE and the County.

Notice of the filing of SCE’s application was published in the Commission’s Daily Calendar on September 27, 2001. No one filed any protest or response to the application, and no evidentiary hearings were held.

Settlement Agreement

According to the public version of SCE’s application, the principal terms of the parties’ settlement are memorialized in the settlement agreement that was filed under seal. The non-public version of the application describes the principal terms of the settlement agreement, and contains a discussion as to why SCE believes the settlement agreement is reasonable and should be adopted.

Neither the public nor non-public version of the prepared testimony discuss the terms of the settlement. Instead, the prepared testimony is limited to a description of the QF contract, the disputes, the events surrounding the energy crisis in California, and the events leading up to the negotiations and eventual settlement of the disputes.

In order to determine what is provided for in the settlement, we reviewed the non-public settlement agreement, and the public and non-public versions of the application and the prepared testimony, as well as the QF contract and the amendments. The following discussion of the issues is based on our review of the settlement agreement, and the other pertinent documents.

Discussion

The Commission's settlement and stipulation rules are found in Rules 51 to 51.10 of the Commission's Rules of Practice and Procedure. A review of the settlement and stipulation rules suggest that the rules were designed for the purpose of reviewing a settlement or stipulation filed after a proceeding is initiated at the Commission. For example, Rule 51.2 states: "Parties to a Commission proceeding may propose a stipulation or settlement for adoption by the Commission (1) any time after the first prehearing conference and (2) within 30 days after the last day of hearing."

The proposed settlement in this application did not arise as a result of an ongoing proceeding. Instead, SCE's application was filed to seek approval of the proposed settlement between itself and the County. Thus, the preliminary issue to address is whether the Commission should review the proposed settlement using the settlement and stipulation rules.

Since the application itself centers around the proposed settlement, SCE and the County did not convene a settlement conference with notice and

opportunity to be heard. Rule 51.1 would require a settlement conference to be held if the settlement was proposed for adoption after the filing of an application. We note, however, that persons interested in this proposed settlement have been provided with notice of SCE's application by virtue of the notice of the filing of SCE's application in the September 27, 2001 Daily Calendar. No one filed any protest or response to SCE's application to approve the proposed settlement.

The issues being resolved in the settlement center around the QF contract that was entered into between SCE and the County. SCE seeks Commission approval of the proposed settlement because the settlement involves events which triggered various contract provisions, and resolves the issues in the context of the contract provisions. In addition, since ratepayers will be affected by any amount that SCE pays under the settlement, SCE requests that the Commission authorize the recovery of all payments made pursuant to the settlement agreement.

A strict reading of the settlement and stipulation rules persuade us that several of these rules do not apply to the proposed settlement at issue in this proceeding. However, the settlement rules set a standard that provides guidance as to how we should review the settlement of this QF contract. Specifically, Rule 51.1(e) provides in pertinent part that the Commission will not approve a settlement unless the "settlement is reasonable in light of the whole record, consistent with law, and in the public interest." We review the proposed settlement between SCE and the County with that criteria in mind.

SCE states in its application that it seeks Commission approval of the resolution of disputes between SCE and the County regarding the County's performance under the contract. The proposed settlement agreement would

resolve the disputes between the two, and end over two years of controversy between SCE and the County. SCE also asserts that the settlement is just and reasonable from the perspective of the ratepayers since the settlement falls well within the range of possible outcomes. SCE's application states that the County had given every indication that it would proceed with litigation against SCE if no settlement was reached.

We have reviewed the QF contract and the two contract amendments, the circumstances giving rise to the settlement, as well as the terms of the proposed settlement. Without disclosing the terms of the settlement, since the terms of the settlement have been sealed, the terms of the settlement are reasonable given the range of outcomes that could result if the County decided to pursue its claims against SCE in court. For example, the settlement resolves the uncontrollable force issue, which the County claims it is entitled to approximately \$788,500 from SCE. The settlement also resolves the issues regarding the probationary period and derating of the project, for which SCE claims that the County owes approximately \$7 million. In addition, the settlement avoids the costs that would have resulted from litigating the disputes.

If these disputes were litigated, it is unclear at this point, based on the description of the disputes and the parties' positions, whether a trier of fact would agree with SCE's position or with the County's position. The settlement has also provided SCE and the County with the opportunity to carefully assess the strengths and weaknesses of their positions. Given the amount of the potential claims, the litigation risks that SCE and the County could be exposed to if these disputes were litigated, and the terms agreed upon in the settlement agreement, we conclude that the proposed settlement of the issues between SCE and the County is fair, adequate, reasonable, and prudent in light of the whole

record, and that the settlement is consistent with the law and in the public interest. Accordingly, the settlement agreement entered into between SCE and the County should be approved. Consistent with Rule 51.8, this settlement is not precedential and does not constitute approval of any principle or issue in future proceedings.

We turn next to the issue of cost recovery. SCE requests that it should be authorized to recover in rates all payments that it made or will make to the County pursuant to the settlement agreement through SCE's Annual Transition Cost Proceeding (ATCP), or any other successor mechanism, subject only to SCE's prudent administration of the settlement agreement and the contract between SCE and the County.

The ATCP was established in D.97-06-060 (72 CPUC2d 736, pp. 770, 790) as part of the establishment of the transition cost balancing accounts. In D.97-11-074 (76 CPUC2d 627), the Commission authorized the utilities to collect the transition costs resulting from QF contracts above market pricing to be recovered in the ATCP. (76 CPUC2d at p. 712.) The reasonableness of the QF contract administration is to take place in the ATCP as well, to the extent that such reviews have not been eliminated by the standard offers or other approved contracts. (76 CPUC2d at pp. 713, 740.)

Since we have determined that the settlement terms are fair, adequate, reasonable, and prudent, we authorize SCE to recover in rates all payments that it has made or will make to the County pursuant to the settlement agreement through SCE's ATCP, or any other successor mechanism, subject only to SCE's prudent administration of the settlement agreement and the contract between SCE and the County.

Since this matter is uncontested, and this decision grants the relief requested, the comment period is waived as provided for in Rule 77.7(f)(2).

Findings of Fact

1. SCE and the County entered into a Standard Offer No. 2 QF contract on November 5, 1985.
2. The County provides SCE with firm capacity under the contract.
3. Certain disputes about the contract regarding the County's firm capacity performance, uncontrollable force events, the institution of a probationary period, and payment offsets arose in 1999 and 2000.
4. SCE and the County reached a settlement of these issues, which became effective on July 5, 2001.
5. Notice of the filing of SCE's application seeking approval of the settlement agreement was published in the Commission's Daily Calendar on September 27, 2001.
6. No one filed any protest or response to the application, and no evidentiary hearings were held.
7. The terms of the settlement between SCE and the County are memorialized in the settlement agreement that was filed under seal.
8. The proposed settlement is the central focus of SCE's application, and did not arise as a result of an ongoing proceeding.
9. The Commission has reviewed the QF contract and amendments, the circumstances giving rise to the settlement, and the terms of the proposed settlement.
10. The settlement resolves the monetary claims and issues in dispute about uncontrollable force, the probationary period, and derating of the project, and avoids the costs associated with further litigation.

11. The settlement has provided SCE and the County with the opportunity to carefully assess the strengths and weaknesses of their positions.

12. D.97-11-074 authorized the utilities to collect the transition costs resulting from QF contracts above market pricing to be recovered in the ATCP, and that the reasonableness of the QF contract administration take place in the ATCP.

Conclusions of Law

1. Persons interested in the proposed settlement of issues between SCE and the County were provided with notice of SCE's application by virtue of the notice of the application's filing in the September 27, 2001 Daily Calendar.

2. Several of the settlement and stipulation rules do not apply to the proposed settlement at issue in this proceeding.

3. Rule 51.1(e) should be used to review the proposed settlement agreement because that rule sets a standard that provides guidance for evaluating a proposed settlement.

4. The terms of the proposed settlement of the issues between SCE and the County are fair, adequate, reasonable, and prudent in light of the whole record.

5. The proposed settlement agreement is consistent with the law and in the public interest.

6. The settlement agreement entered into between SCE and the County should be approved.

7. Consistent with Rule 51.8, this settlement is not precedential and does not constitute approval of any principle or issue in future proceedings.

8. SCE should be authorized to recover in rates all payments that it has made or will make to the County pursuant to the settlement agreement through SCE's ATCP, or any other successor mechanism, subject only to SCE's prudent

administration of the settlement agreement and the contract between SCE and the County.

O R D E R

IT IS ORDERED that:

1. The July 5, 2001 settlement agreement between Southern California Edison Company (SCE) and the County of Los Angeles (County) pertaining to the Pitchess Honor Rancho cogeneration facility is approved.

2. SCE is authorized to recover in rates all payments that SCE made or will make to the County pursuant to the settlement agreement through SCE's Annual Transition Cost Proceeding, or any other successor mechanism, subject only to SCE's prudent administration of the settlement agreement and the contract between SCE and the County.

3. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.